



May 9, 1997

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative:

Thank you for your letter of April 9, 1997. The Lower Colorado River Authority (LCRA), as a member of the Large Public Power Council (LPPC), has testified and participated in several of the electric restructuring hearings in the 104th and 105th Congress. We are pleased to have the opportunity to respond directly to the issues raised in your letter.

1. *What concerns does your company have in connection with increased competition in wholesale markets? If state(s) you serve have adopted, or are considering adopting retail competition, what issues have been most important to you and what, if any, concerns do you have with respect to state action?*

First, let me state that we support the following guiding principles as the test for new legislation - lower prices for residential customers, protection of all investors, fair stranded cost recovery, environmental protection, reliable and universal service, and the empowerment of the states to act in the best interest of their citizens. The LCRA believes the transition to customer choice is best made at the local and state level. We believe that market forces--already underway in many states without unnecessary and costly federal intervention--will bring about good, locally tailored choices for consumers. Local control is particularly appropriate when one considers the local priorities involved: local economic development, balancing environmental priorities with electric rate setting and assuring universal service for all. These issues are best left to local officials--and are not amenable to a federal "one size fits all" approach.

The LCRA does not have any particular issues with increased competition in the wholesale markets. In general, the LCRA supports electric competition that will provide benefits to all of our customers. As competition increases in general, the LCRA and all public power entities will have increasing concerns over federal "private-use" restrictions on tax-exempt financed assets. These arcane IRS regulations must be dealt with in order for public power to compete effectively.

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If Texas adopted retail competition, the issues most important to the LCRA would be:

- 1) Honoring existing contracts;
 - In any transition to a retail access world, we would want to be sure that our existing wholesale power supply agreements would continue to be honored.
- 2) Public power options to control implementation and timing;
 - California and Pennsylvania have both created options that essentially give public power systems local control over the timing of retail access. We would support similar mechanisms in Texas.
- 3) Stranded cost recovery;
 - We support the fair recovery of stranded costs and would want to ensure such recovery is recognized and authorized for all public power systems.
- 4) Market structure, i.e. whether structural unbundling is mandatory.
 - We support the concept of functional unbundling in order to create focused business units in the electric utility industry. We do not believe a mandatory structural unbundling of generation, transmission and distribution businesses is necessary.

Our main concerns are that public power be treated in a manner that is compatible with its basic structure and mission: tax-exempt, nonprofit entities that were created solely to serve their customers with low-cost, reliable electric services. To that end, state restructuring laws must provide the key elements listed above.

2. *What challenges would your company face if Congress mandated retail competition by a date certain? How would this affect your rights and responsibilities? What issues would have to be addressed, including but not limited to modifications to the tax laws, for you to successfully make the transition? What consequences would result if such issues are not specifically addressed, what interests would be affected, and how?*

We believe that federal legislation should focus on removing federal barriers to competition. The most important federal barrier to competition for public power are IRS' private-use restrictions discussed below. If additional federal legislation is necessary, it should be comprehensive in nature, and address all areas relevant to deregulation and restructuring of the electric utility industry.

On retail choice and retail wheeling, LCRA believes that at present there is not a need for any federal mandate; rather, the impacts of wholesale competition spurred by the 1992 Energy Policy Act and FERC Order 888 should be allowed to proceed and its

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benefits and impacts should be studied. Concerning retail choice, numerous experiments and initiatives are underway in the states, and lessons should be learned from those. The effects of these policies should be weighed before federal mandates are enacted; instead, a neutral Government entity such as the GAO should be tasked with reporting to Congress, no later than five years from the enactment of legislation, on the impacts of the federal and state actions in providing benefits through competition to all consumers. If necessary, Congress could act at that time, and it would do so with the knowledge of what has been successful in benefiting consumers and what hasn't, and what specifically needs to be done.

Concerning FERC jurisdiction over public power transmission systems, it should be recognized that by virtue of Section 211 of the Federal Power Act, publicly owned transmission systems are subject to regulation now. Congress should not be seeking to impose new federal regulatory jurisdiction on anyone unless there is a valid public purpose, and to date no one has articulated a valid public purpose for such additional regulation. If it is deemed appropriate to implement additional regulation, the rules adopted must recognize that public power systems, by virtue of their nonprofit status, are different than investor owned companies, and any rules should respect those special characteristics, including rate setting mechanisms, different financing, etc.

On tax issues, the LCRA recognizes that, in a future competitive environment, retail sales of electricity by public power systems beyond the limits of their traditional service charters may raise tax issues which need to be considered, and we are willing to do so. At the same time, tax issues related to our current assets which may be rendered stranded or uneconomic because of the changing competitive environment also need to be considered and discussed in a comprehensive fashion so that such assets continue to be used productively without adverse consequences for customers or investors.

We urge Congress to resolve a conflict that puts the 1992 Energy Policy Act and the Tax Reform Act of 1986 directly at odds with one another. The tax laws stipulate that a state or local public power system cannot sell more than 10 percent of its transmission capacity to a private entity. And yet the Energy Policy Act, as interpreted by FERC, states that we must make our transmission lines available to everyone. Under existing federal law, complying with one policy means violating the other. The advent of competition in the electric utility industry has made the problems created by the IRS' "private use" restrictions even more acute. These private use restrictions, written in a very different time from the current rapidly changing era of electricity deregulation, now form a serious barrier to open competition and customer choice. Because of the pace of deregulation in the states, it is important that this problem not wait for several years, but be fixed immediately. The IRS' "private use" regulations restrict the amount of

output or capacity a publicly owned electric utility may sell to private parties. In practice, this means that public power utilities cannot sell excess power or capacity to investor-owned utilities, commercial or industrial customers, Indian tribes or even the federal government itself, without causing their outstanding tax-exempt bonds to become taxable. The rules of the game are changing; in fact, they've already changed, and the tax code and the law need to change to accommodate them.

The LCRA is essentially a wholesale provider, and retail competition will present unique challenges. LCRA's electric assets have been primarily funded with tax-exempt revenue bonds. As retail access erodes our wholesale load, LCRA may find itself in a position of having decreasing revenues from which to pay back a highly leveraged debt structure. The LCRA bondholders have a vested interest in how well the LCRA's assets perform in the restructured electric market, and how stranded costs will be handled.

3. *Several states have either adopted or are considering securitization plans to address stranded cost recovery as part of a state retail competition plan. Whose interests are served by such an approach, and what if any risks are posed and for whom?*

Securitization plans are essentially a way to refinance above-market costs. These plans benefit those companies whose cost structure would not allow them to compete in the restructured market. Under the regulatory system that electric utilities have operated under, there is a legitimate claim to recoup investments that were approved under this system. The refinancing of such costs can be done if the above market costs are reconciled to market costs going into the future. Such a true-up to market could be done via a comparison to comparable asset sales or via a divestiture of a portion of a company's assets.

4. *Some states have argued that Congress should enact reciprocity requirements barring sellers in states which have not adopted retail competition from access to markets in states which have done so. Do you believe such legislation is warranted, and why? What consequences would ensue if Congress does not enact reciprocity provisions?*

We do not see a need for such legislation because it does not support our fundamental belief in an open competitive market. Restricting sellers from others states restricts the number of players in the market and would decrease the consumers choices on services and pricing. We believe that as competitive forces come more fully into play that those states that have not adopted retail access will do so over time, in accordance with the desires of their consumers.

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In conclusion, the LCRA supports open access and customer choice. Locally-owned public power systems serve to enhance competition, and thereby the benefits that competition brings to the American people. We need Congressional assistance to ensure that the customer gets to make the decision in the marketplace. Right now, the private use restrictions which grew out of the Tax Reform Act of 1986 are a serious barrier to open competition and customer choice. Public power systems are unable to react to the new competitive environment mandated by Congress because of our inability to comply with both the federal energy policy and the federal tax law. In essence, public power systems have a choice of violating either FERC or IRS rules. It seems reasonable that federal energy policy and the federal tax law are consistent in their applications. Consequently, we believe that a statutory solution to private use limitations is in the interests of all customers and public policy.

Mr. Chairman, let me assure you that we are prepared with you and your colleagues and all our colleagues in the states to work toward a competitive and reliable electricity marketplace, and a new set of rules for that future. Again, we appreciate the opportunity to provide our comments, and we are ready to work with you to move in the direction of customer choice.

Yours truly,



Mark Rose
General Manager